

# DOW THEORY LETTERS INC.

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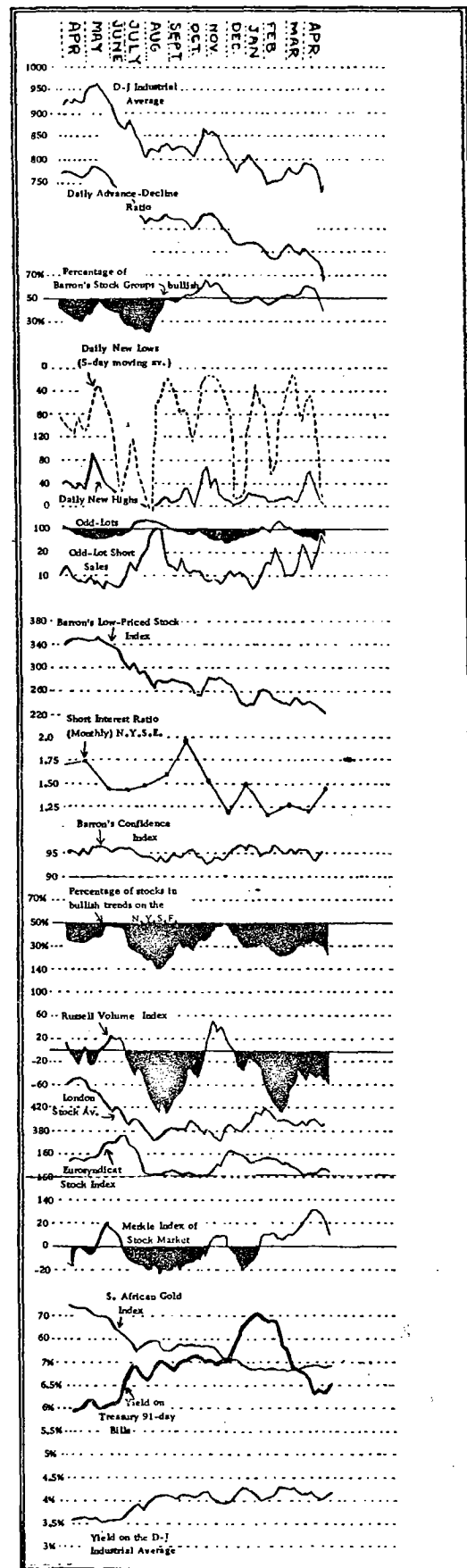
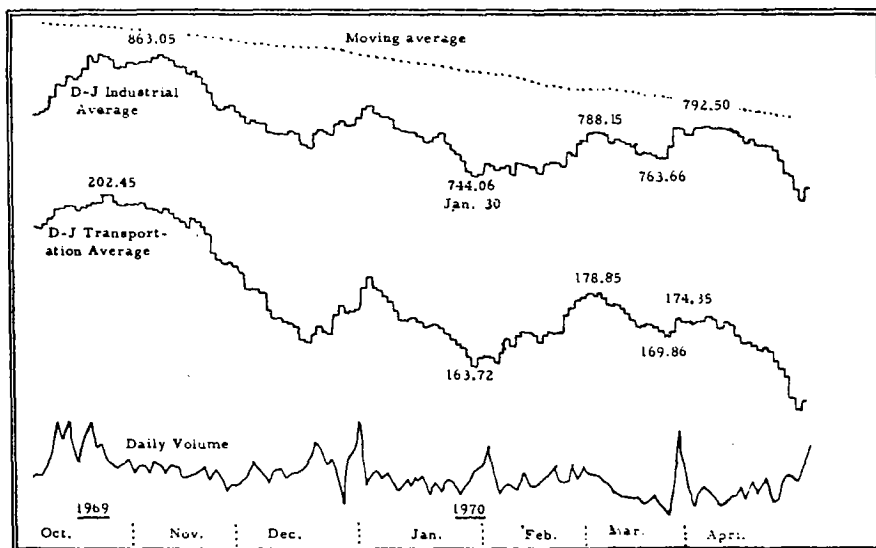
Letter 460

**THE MARKET:** On April 23 (Thursday) the D-J Transportation Average broke under its January 30 low to close at a new low for the bear market (see bottom chart on this page). Two trading days later (Monday, April 27), the D-J Industrials Averages dropped 12.14 points, thereby smashing its own January low of 744.06 and confirming the penetration of the Transportation Average. The joint new lows re-confirmed the existence of a primary bear market.

Incredibly, the smashing of the earlier 1970 lows came on the 18th day of consecutive decline in the advance-decline ratio. The collapse in the Dow obviously did not begin to reflect the damage suffered by the rest of the market.

I have the A-D ratio charts going back to 1919. I have the actual daily statistics going back to May 12, 1930. According to my studies, the worst previous consecutive string of downside days in breadth occurred between June 2 and June 23, 1969, a performance which saw the A-D ratio decline for 16 straight days for a loss of 4.98 on the A-D ratio. The string of declines leading up to the April 27 smash comprised 18 consecutive days of decline which erased 5.14 points from the A-D ratio. As such, the April action must rate as the worst breadth collapse in history. Whether this performance is one of the "fruits" of our modern "regulated" market and economy I do not know. Suffice it to say that it constitutes a new record in Wall Street annals.

The April tumble has effected almost every stock issue traded in the North American markets. Along with the decline in stocks, bonds have also skidded to near record lows. The spector of sharply lower corporate profits, higher wages, continued inflation, near-record interest rates, a large budget deficit, a crisis situation in Cambodia and gathering legislative opposition to President Nixon has cast a giant gathering cloud over the securities markets. For the first time since 1966, investors are beginning to see the real teeth of the bear.



Page 2 I include this point & figure chart  
(courtesy Chartcraft, Larchmont, N.Y.)

in order to provide the perspective that the April action deserves. This is a 10-point, 30-point reversal chart of the Dow. Each box on the chart represents 10 points, and only rallies or declines of a full 10 points or more are shown. Rallies are denoted by X's, declines by O's.

Point E on the chart marks the 995.15 bull market top of 1966. At C

(744.32 low of 1966)

and D (744.02 low of

January, 1970) we

see what I referred to

in previous Letters

as the critical bear

market low or major

area of support. Since

neither the decline of

1966 nor the decline

of early-1970 touched

740.00 on an hourly

or a closing basis, the

C and D marks on the

chart are drawn in at

the 750 level. On

April 27 the Dow

closed at 735.15,

thereby taking the

last string of O's (the

last decline) down to

the 740 level. This

constitutes the

breaking of the entire

E-C-D formation, a

top which was four

years in the making.

The C, D and most

recent (April) decline

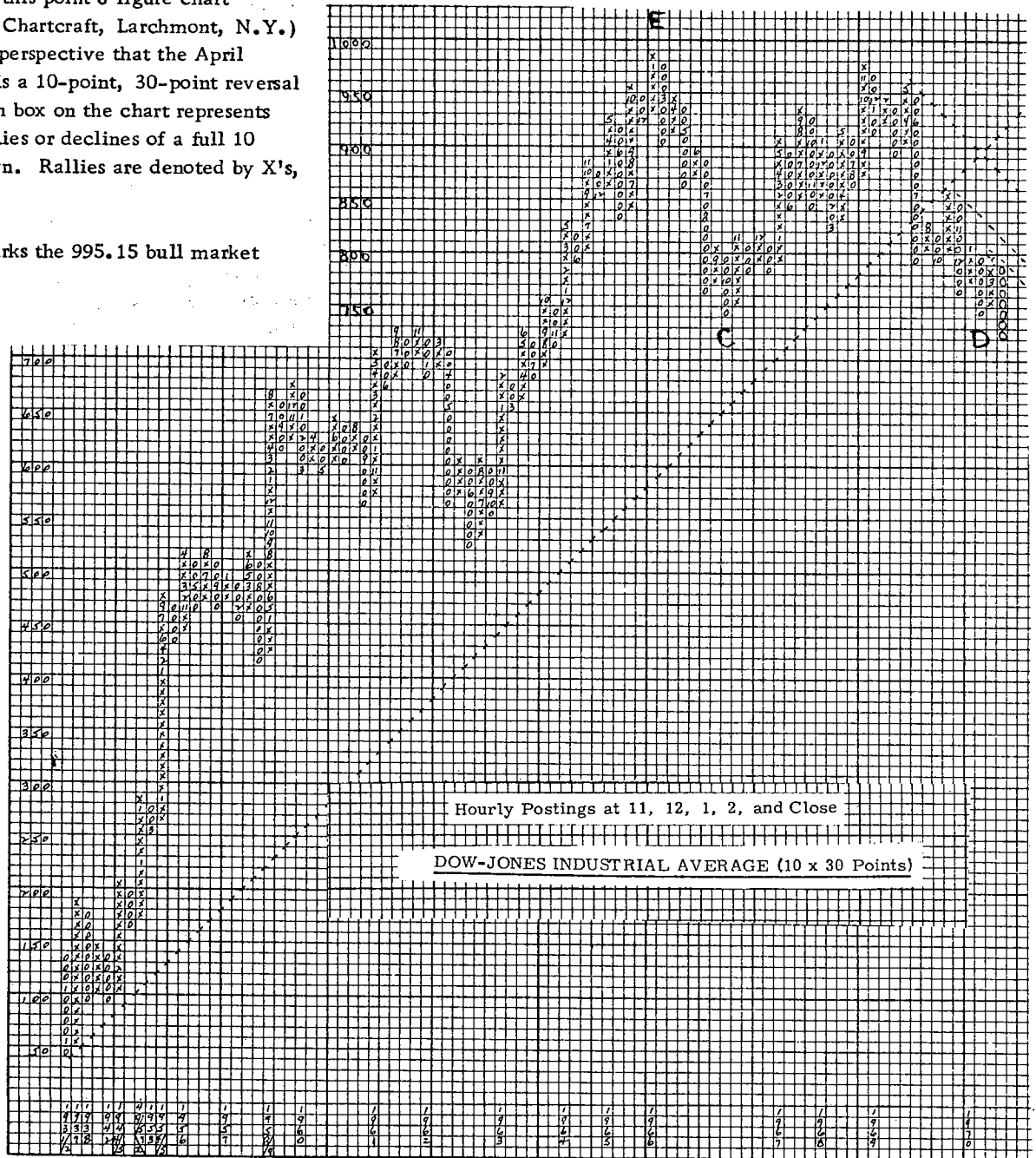
constitutes what is

termed a "spread

triple bottom" in

point & figure parlance.

The shattering of this bottom usually constitutes a most powerful penetration.



What happens from here? From the chart standpoint, the situation could not appear worse. The penetration of the huge triple bottom has occurred below the great ascending trendline which starts in 1932. It has occurred following what surely is one of the most massive periods of distribution in the history of the stock market. It has occurred following a "top" which is so huge that we have nothing in past history to compare it with.

Again, I say that what happens over the near-term is relatively unimportant. On most measurements, the market appears "over-sold" and due for a rally. On other indications, such as current volume, one would conclude that complacency still seems to be the predominate psychology of Wall Street and the nation. Major movements during primary bear markets seldom end with the same volume in which they began. Sooner or later, this bear market seems fated to set off a wide-open panic, a panic loud enough to be heard around the world. That phenomenon could start in a week or a year. But I believe it is coming. Our policy, as I have stated over and over again since this bear market began, is to stay out, stay liquid and prepare for the storm. The real storm, I hesitate to opine, still lies ahead.

**MOST-ACTIVE STOCKS INDICATOR:** I made a mistake in my calculations in the last report. The 20 most-active indicator was minus 39 for the week ending April 17, not minus 42 as reported. For the week ending April 25 the indicator dropped to a resounding minus 50.

A subscriber called and gave me the following figures associated with the famous 1937 crash. Here are some of the readings of the most-active indicator during that period: Week ending September 4, 1937 indicator was minus 51, week ending Sept. 11 at minus 51, week ending Sept. 18 at minus 54, week ending Sept. 25 at minus 50, week ending Oct. 2 at minus 10, week ending Oct. 9 at minus 20, week ending Oct. 16 at minus 40, week ending Oct. 23 at minus 47, week ending Oct. 23 at minus 9.

**50% PRINCIPLE:** I am publishing this arithmetic chart of the D-J Industrials (high and low monthly) from M.C. Horsey, Salisbury, Md. 21801. I am using an arithmetic chart because I want to show distance or ground covered by the Dow, not percentages.

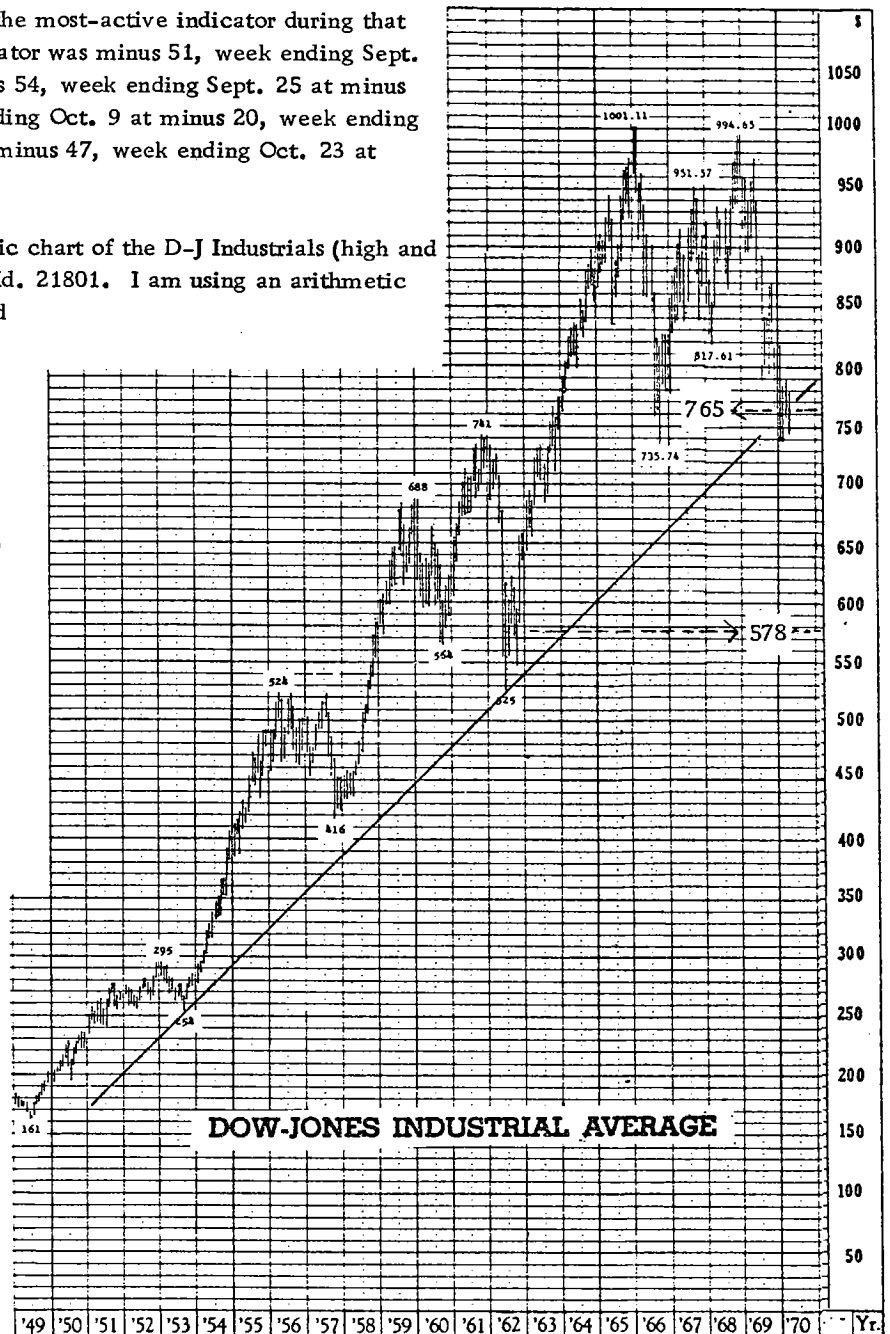
The 50% Principle states the following: After an extended advance, the termination point of the ensuing correction should be watched carefully. If the correction can halt while retaining 50% or more of the previous advance, it is a positive indication, and there is a good chance that movement will rally to test the area of the high again. Conversely, if the correction wipes out more than 50% of the previous extended advance, it is a negative indication, and there is a good chance that the movement will continue down, ultimately testing the area from which the entire advance started.

It should be remembered that this is a theory, and although it has worked many times in the past there is nothing immutable about this theory (or observation, if you wish to call it that). Second, the 50% Principle should not be applied to short-term movements; it should only be applied to major movements lasting six months to a year or many years.

There are two important applications of the 50% Principle which may be coming into prominence. First, referring to the chart, note that the Dow has broken the long-term trendline connecting the 1953 and 1962 bottoms. This is obviously a bearish indication, suggesting a reversal of the entire rising trend since 1949. The fact that this occurred within the framework of a primary bear market makes the penetration of the trendline doubly significant. I do not believe, in other words, that this was a "false" penetration.

If we measure the advance from the 1962 low of 535.76 on the Dow to the final 1966 peak of 995.15, we note that the movement carried 460 points. The halfway point of the 1962 to 1966 rise was thus 765. This means that during the 1966 and again during the most recent decline the Dow decisively broke the 50% level. The implication under the 50% Principle is that the Dow will probably test the area from which the movement began, or the 1962 area of 535. Whether this will happen remains to be seen, but at any rate that is the implication of the 50% Principle.

The second important consideration is that the entire primary bull market covered a distance of 834 points; from the 161.60 of 1949 to 995.15 of 1966. The halfway point of the whole bull market rise is thus 578. I feel that if the Dow breaks to lower levels, it will be important to see what happens if and when 578 is approached.



Page 4 If a bottom can be formed at or above 578, particularly during a period which shows third phase characteristics, it will be a positive sign. Conversely, if 578 is decisively penetrated, I would take it as a most bearish and tragic sign. If 578 is broken decisively on the downside, my guess is that the final bottom of the bear market will arrive at an area far lower than anyone now thinks possible.

**PHASES:** A primary bull market can be likened to a stirring adventure-drama, in which all the players experience victory, even though the final wind-up of a bull market may appear more like a Roman orgy than a morality play. Conversely, a primary bear market is a tragedy; it is the eerie black night which follows a sparkling sunny day.

Last week Mr. Harry Schwarzmann (Pres., Capital Gains Research Bureau) sent me one of his late reports, and I feel that a few of his statistics are well worth studying. During the single year 1969 the N.Y.S.E. alone saw a shrinkage of \$61 billion in listed values. As if 1969 was not bad enough, the month of January, 1970, alone saw a Big Board loss of \$45 billion, which was nine times the monthly average of 1969. February witnessed a recovery of \$32 billion, and although I do not have the March and April, 1970 figures, it is obvious that all of February's recovery plus much more has now been wiped out.

In fact, since January, 1969, it seems obvious that considerably more than \$100 billion in values have been erased from the Big Board alone. This amount, to put it in context, is equal to half the current national budget. Seen another way, if we figure that there are approximately 25 million stockholders in the U.S., the N.Y.S.E. losses since January, 1969, add up to around \$4,000 per individual. I won't even go into the horrendous Amex and over-the-counter losses (or the bond losses) which have been sustained, but these figures illustrate that the stock market not only reflects coming conditions, but it directly affects those conditions during the course of a great primary movement.

At the same time, the market speculators are slowly being crushed by the bear. A year ago the N.Y.S.E. listed 940,000 margin accounts. The latest figure is 835,000, down 105,000. With the exit of the margin speculators goes the margin money, and the figures show that there was \$5.75 billion in margin accounts a year ago. That figure has dropped to \$4.62 billion, a loss of \$1.13 billion.

"What's Russell trying to do?" a subscriber may ask. "Doesn't he want me to sleep nights, or is he just being some kind of a sadist?" The answer, I think, is that I am not a sadist, and I would imagine my subscribers are sleeping better these nights than about 95% of the other people who have anything to do with Wall Street. But I am trying (as I have been ever since the bull market topped out in February, 1966) to show my readers that you can't beat the primary trend. To be invested during a bear market or to be short during a bull market is a ticket to disaster. I have repeated that thesis until I am sure it is now a part of every one of my subscribers' conscious and unconscious minds.

I have mentioned before that in my judgment, the bear market is now deep in its second psychological phase. This is the phase in which stocks go down in anticipation of obviously deteriorating economic, social and political conditions. The deterioration in all three of those areas is now becoming more and more visible, and investors are liquidating in anticipation of the events.

On April 28 the Dow plunged below its earlier 744.06 low, and this merely means to me that the second phase of the bear market is continuing. As I have written many times before, there is no way of telling when the second phase of the bear market will end. I cannot be certain of it now, but I would guess that the second psychological phase will end at whatever point the current major downward price movement terminates. This could be 650, 550 or 500, no one can possibly know. Following the end of the second phase, we probably will have some sort of secondary (upward) correction. Because the correction following the first phase (i.e., 1966 to 1969) was so great, I am guessing that the correction following the second phase will be sub-standard. At any rate, after the second phase correction we will begin the third or final psychological phase of the bear market.

The third phase is the true liquidation phase, but if it follows the pattern of previous major bear markets it will not be liquidation by choice, it will be selling "under pressure." Perhaps a few quotes from the great Dow Theorist, Robert Rhea would be in order at this time.

On Sept. 29, 1937, he wrote, "I believe we are entering the second phase of the primary downtrend where prices of individual issues collapse suddenly in response to public recognition of the influences of adverse factors upon earnings.....Should this bear market proceed in the conventional manner, then during its third and final phase the best stocks will suffer equally with the trash, because people will be forced to sell their rainy day funds, and business to liquidate investment reserves, for the simple reason that they will need cash."

Again, on March 26, 1938, Rhea offered this description of the third phase of a bear market: "It is in the third phase of a bear cycle when people sell their good stocks, held against a rainy day, because it is raining (watch the blue chips); corporations sell investment securities to obtain money for payrolls, taxes and other expenses; receiverships increase, and business

paralysis develops because labor has lost its job and cannot buy; and rich men's purchasing power vanishes with curtailed dividends and because of defaulted bonds. These and other things, cause stocks to sell below intrinsic value in the third phase of a bear market."

As my veteran subscribers know, I am constantly worried that my readers will think only in terms of the short to medium term. The primary trend usually makes mince-meat out of those who suffer from near-sightedness. For instance, 1967 and '68 saw a great upward correction in a bear market. I was certainly one of the greatest upward corrections in bear market history. Yet, where are all our friends who made a "killing" on the rally? How many people do you know who are still talking about the fortune they accumulated between 1966 (the bull market peak) and today? Personally, I hear about nothing but losses, despite the great 1967-68 (and most of 1969) rally.

I have warned all along that bear markets are made to separate stock holders from their bank accounts. A bear market is an extended period of liquidation, and nightly each and every stock certificate in existence is held by someone. Those people suffer losses in a primary bear market, and the people they sell their losses to sustain further losses. Our job is to stay out of the market until the storm is over, regardless of whether the storm ends a year from now or three years from now.

I also wrote repeatedly that the second (current) phase of a bear market is the most deceptive of the three phases. So far, this second phase has been no exception, and it is not over yet. Study any chart of the action since October, 1966, and count the times the market has rallied, then dashed the hopes of Wall Street. It is not a pretty calculation, but it is one I have tried to prepare subscribers for.

**SEEDS OF THE STORM:** "I suppose the political turning point in my life came while I was in Uganda. I was there when American planes were bombing the Congo, and we were very close to the Congo border. The planes came over and bombed two villages in Uganda (I don't know how the hell anyone figures out where the borders are). But it wasn't that; it was what the hell were American planes doing, piloted by Cubans, bombing the Congo when as far as I knew, the United Nations was the peace-keeping force in the Congo. Where the hell did the American planes come in?" From Mary Moylan's story, one

of the nine convicted of burning draft files on May 17, 1968 outside Baltimore.

#### The largest Department of Defense contractors

|                | RANK | AWARDS (\$MIL) |      |      |  |
|----------------|------|----------------|------|------|--|
|                | 69   | 69             | 68   | 67   |  |
| LOCKHEED       | 1    | 2040           | 1870 | 1807 |  |
| GEN ELEC       | 2    | 1621           | 1489 | 1290 |  |
| GEN DYNAM      | 3    | 1243           | 2239 | 1832 |  |
| MCDONNLL DGL   | 4    | 1070           | 1101 | 2125 |  |
| UNITED AIRCR   | 5    | 997            | 1321 | 1097 |  |
| AT&T           | 6    | 915            | 776  | 673  |  |
| LING TEMCO     | 7    | 914            | 758  | 535  |  |
| N AMER ROCKW   | 8    | 674            | 669  | 689  |  |
| BOEING CO      | 9    | 654            | 762  | 912  |  |
| GEN MOTORS     | 10   | 584            | 630  | 625  |  |
| RAYTHEON       | 11   | 547            | 452  | 403  |  |
| SPERRY RAND    | 12   | 468            | 447  | 484  |  |
| AVCO CORP      | 13   | 456            | 584  | 449  |  |
| HUGHES AIRC    | 14   | 439            | 286  | 420  |  |
| WESTINGHOUS    | 15   | 430            | 251  | 453  |  |
| TEXTRON        | 16   | 428            | 501  | 497  |  |
| GRUMMAN        | 17   | 417            | 629  | 488  |  |
| HONEYWELL      | 18   | 406            | 352  | 314  |  |
| FORD MOTOR     | 19   | 396            | 381  | 404  |  |
| OLIN MATH      | 20   | 354            | 329  | 154  |  |
| LITTON INDS    | 21   | 317            | 466  | 180  |  |
| TELEDYNE       | 22   | 308            | 93   | 88   |  |
| RCA            | 23   | 299            | 255  | 268  |  |
| STAND OIL NJ24 | 24   | 291            | 274  | 235  |  |
| MART MARIET    | 25   | 264            | 393  | 290  |  |
| GEN TIRE       | 26   | 264            | 248  | 273  |  |
| IBM            | 27   | 257            | 224  | 195  |  |
| RAY-MOR-KND    | 28   | 254            | 176  | 136  |  |
| IT&T           | 29   | 238            | 242  | 255  |  |
| TENNECO        | 30   | 237            | -    | -    |  |
| DUPONT         | 31   | 212            | 171  | 180  |  |
| FMC CORP       | 32   | 196            | -    | -    |  |
| NORRIS IND     | 33   | 188            | 139  | 128  |  |
| BENDIX         | 34   | 184            | 224  | 296  |  |
| HERCULES       | 35   | 180            | 171  | 195  |  |

#### The largest NASA prime contractors

|               | RANK | AWARDS (\$MIL) |       |        |  |
|---------------|------|----------------|-------|--------|--|
|               | 69   | 69             | 67    | 65     |  |
| N AMER ROCKW  | 1    | 680.9          | 983.8 | 1099.4 |  |
| GRUMMAN       | 2    | 369.2          | 481.1 | 267.2  |  |
| BOEING        | 3    | 228.7          | 273.5 | 306.0  |  |
| MCDONN DGLS   | 4    | 207.5          | 243.9 | 166.7  |  |
| G E           | 5    | 150.1          | 179.3 | 181.5  |  |
| BENDIX        | 6    | 127.6          | 120.0 | 66.1   |  |
| I B M         | 7    | 112.5          | 186.4 | 128.3  |  |
| AEROJET GEN   | 8    | 64.9           | 95.7  | 123.2  |  |
| MARTIN MARIET | 9    | 56.0           | 12.8  | 8.4    |  |
| R C A         | 10   | 51.6           | 57.5  | 106.6  |  |
| TRW INC       | 11   | 50.0           | 52.6  | 50.5   |  |
| CHRYSLER      | 12   | 42.5           | 76.6  | 86.0   |  |
| LOCKHEED      | 13   | 39.8           | 42.0  | 35.8   |  |
| T W A         | 14   | 35.4           | 25.1  | 20.9   |  |
| SPERRY RAND   | 15   | 34.1           | 38.7  | 39.4   |  |
| GEN DYNAM     | 16   | 34.0           | 61.0  | 111.1  |  |
| G M           | 17   | 30.9           | 65.2  | 72.5   |  |
| FED ELEC      | 18   | 27.0           | 12.3  | -      |  |
| UNITED AIRCR  | 19   | 26.2           | 40.0  | 43.3   |  |
| SVC TECH      | 20   | 26.2           | -     | -      |  |
| PHILCO FORD   | 21   | 22.4           | 32.1  | 30.0   |  |
| CATALYT DOW   | 22   | 19.4           | 11.1  | 25.3   |  |
| LTV AEROSP    | 23   | 18.3           | 46.3  | 15.1   |  |
| BROWN/NORTH   | 24   | 12.7           | 10.0  | -      |  |
| NORTHR CORP   | 25   | 12.4           | 8.8   | 7.3    |  |
| ILC INDS      | 26   | 12.2           | 6.3   | -      |  |
| BROWN ENGN    | 27   | 11.1           | 16.7  | 30.9   |  |
| BELLCOMM      | 28   | 10.1           | 9.3   | 9.8    |  |
| SINGER GEN    | 29   | 9.7            | -     | -      |  |
| UNION CARB    | 30   | 8.9            | 12.6  | 20.0   |  |
| GARRETT       | 31   | 8.9            | 9.3   | 7.2    |  |
| COMM SAT      | 32   | 8.7            | -     | -      |  |
| AM SCI&ENG    | 33   | 8.4            | 4.2   | -      |  |
| COMPUT SCI    | 34   | 8.3            | 11.8  | -      |  |
| HONEYWELL     | 35   | 8.1            | 22.6  | 27.1   |  |

#### The largest Research & Development contractors

|               | RANK | 69    | 68    | 67    |
|---------------|------|-------|-------|-------|
|               |      | \$MIL | \$MIL | \$MIL |
| LOCKHEED      | 1    | 645.0 | 918.8 | 708.8 |
| WESTERN ELEC  | 2    | 393.7 | 482.3 | 414.0 |
| GENERAL ELEC  | 3    | 389.0 | 573.1 | 439.1 |
| MCDONNLL DOUG | 4    | 323.1 | 224.4 | 236.8 |
| BOEING CO     | 5    | 257.7 | 220.6 | 220.3 |
| N AMER RWLL   | 6    | 231.8 | 298.2 | 236.2 |
| GEN DYNAMICS  | 7    | 221.9 | 429.1 | 461.1 |
| UNITED AIRC   | 8    | 172.6 | 103.8 | 76.0  |
| HUGHES AIRC   | 9    | 167.5 | 139.7 | 165.9 |
| GRUMMAN AIR   | 10   | 165.5 | 104.7 | 74.3  |
| M MARIETTA    | 11   | 146.0 | 172.0 | 155.8 |
| TRW INC       | 12   | 131.3 | 96.4  | 90.0  |
| RAYTHEON CO   | 13   | 115.4 | 111.8 | 97.6  |
| AEROJET GEN   | 14   | 113.7 | 117.6 | 80.3  |
| PHILCO-FORD   | 15   | 102.0 | 90.8  | 101.9 |
| PAN AM        | 16   | 101.1 | 107.2 | 20.2  |
| RCA CORP      | 18   | 90.2  | 69.8  | 54.4  |
| GEN MOTORS    | 19   | 86.2  | 76.0  | 72.8  |
| WESTINGHOUS   | 20   | 83.1  | 54.4  | 121.8 |
| AVCO CORP     | 21   | 76.4  | 103.6 | 112.2 |
| LTV AEROSPA   | 23   | 57.7  | 6.7   | 11.8  |
| ARO INC       | 24   | 49.8  | 53.2  | 55.6  |
| LITTON SYST   | 26   | 47.1  | 12.2  | 14.4  |
| SPERRY RAND   | 27   | 44.9  | 46.9  | 82.3  |
| TEXAS INSTR   | 28   | 40.2  | 41.1  | 32.2  |

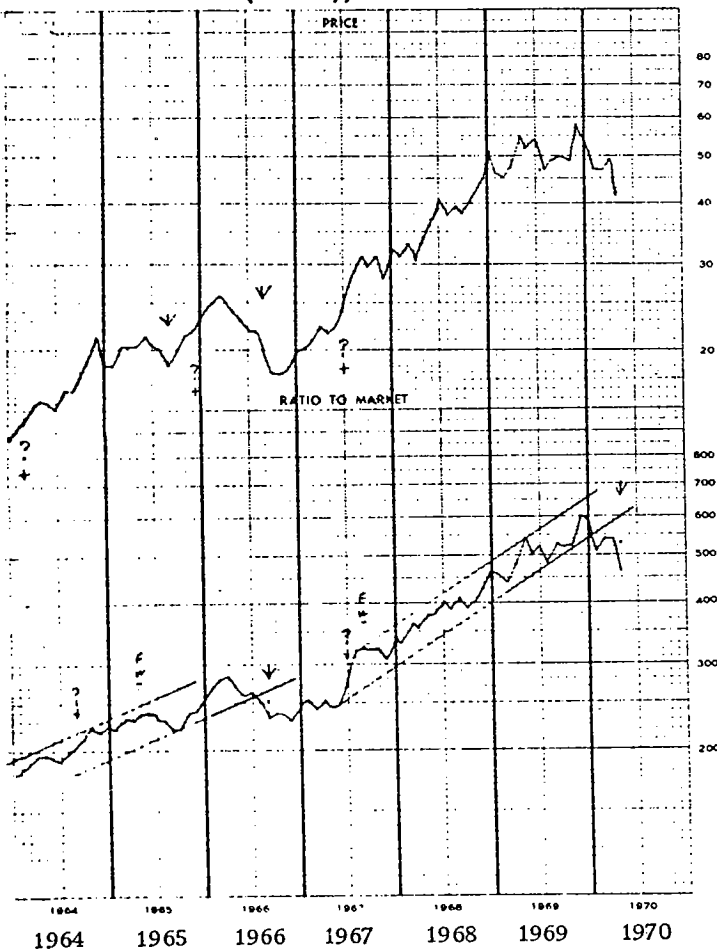
Page 6 The massive debts of World War I were never paid off. The towering debts of World War II were never even dented. Since World War II the U.S. has engaged in arms programs so vast, so colossal, that no one man can comprehend their scope. We have armed most of the world. But like a man with the fever, the markets of the U.S. know sickness when it overtakes them. The disease of debt and the "fever," of high interest rates, have been racking Wall Street for the past few years. The fruits of 25 years of unprecedented spending for death and destruction is now casting its shadow across the land.

Talking about an \$80 billion defense budget probably does not mean much to most people. Therefore, I thought these little partial lists of Government awards would provide subscribers with an idea of what goes on in Washington. Oh yes, the lists go on and on, with classifications such as the 100 largest non-profit R & D contractors, the 200 largest non-profit NASA contractors, etc. As the old song says, "That's where the money goes....."

Here are a few final factual tidbits. The new U.S. budget amounts to Federal spending of \$553 million per day, or \$23 million per hour! The U.S. national debt is now rocketing by \$800 monthly. The "over-ride" on the C-5A military contract of \$2 billion is equal to the entire annual Federal contributions to U.S. education. The Health-Education-Welfare Dept. employs 100,000 people.

**STOCKS:** One of the tools which I find particularly valuable in selecting individual stocks is relative strength or the performance of a stock in relation to "the market". These two typical charts are from Ray-Signals, 42 Broadway, N.Y.C. 10004 (I have reduced these charts 50%). I want to illustrate one factor, and that is that relative strength trends tend to last a long time. Here we see Carter Wallace and Halliburton both reversing R.S. trends to the downside, Carter after a two-year rise in R.S., Halliburton after an interrupted six-year rise. As a rule, the longer a relative strength trend holds in one direction, the more important the ultimate reversal. A downside reversal may not necessarily mean that a particular stock is in "trouble", it may merely mean that the market has fully appraised it, and that interest in the given stock is now declining (perhaps because it is simply selling at too high a P/E ratio). Nevertheless, the price (which is what we are interested in) will decline.

Halliburton (Monthly)



Carter Wallace Inc. (Monthly)

